While volatile, February was overall a flat month for stocks globally, but a good month for bonds as rates generally fell on the longer end of the yield curve. US stocks declined for the month with the S&P 500, Dow Jones Industrial Average, and NASDAQ Composite down 1.3 percent, 1.4 percent, and 3.9 percent respectively. Mid Cap stocks (Russell Midcap) declined 2.8 percent and Small Cap Stocks (Russell 2000) declined 5.4 percent. Growth underperformed value across the capitalization spectrum. Conversely, international stocks and emerging markets had a positive month with the MSCI EAFE rising 2.0 percent and the MSCI Emerging Markets gaining 0.5 percent. Fixed income investments – especially longer dated fixed income – rose substantially in February. The Barclays US Aggregate Bond Index gained 2.2 percent and the Barclays US Treasury 20+ Year Index gained 5.6 percent.

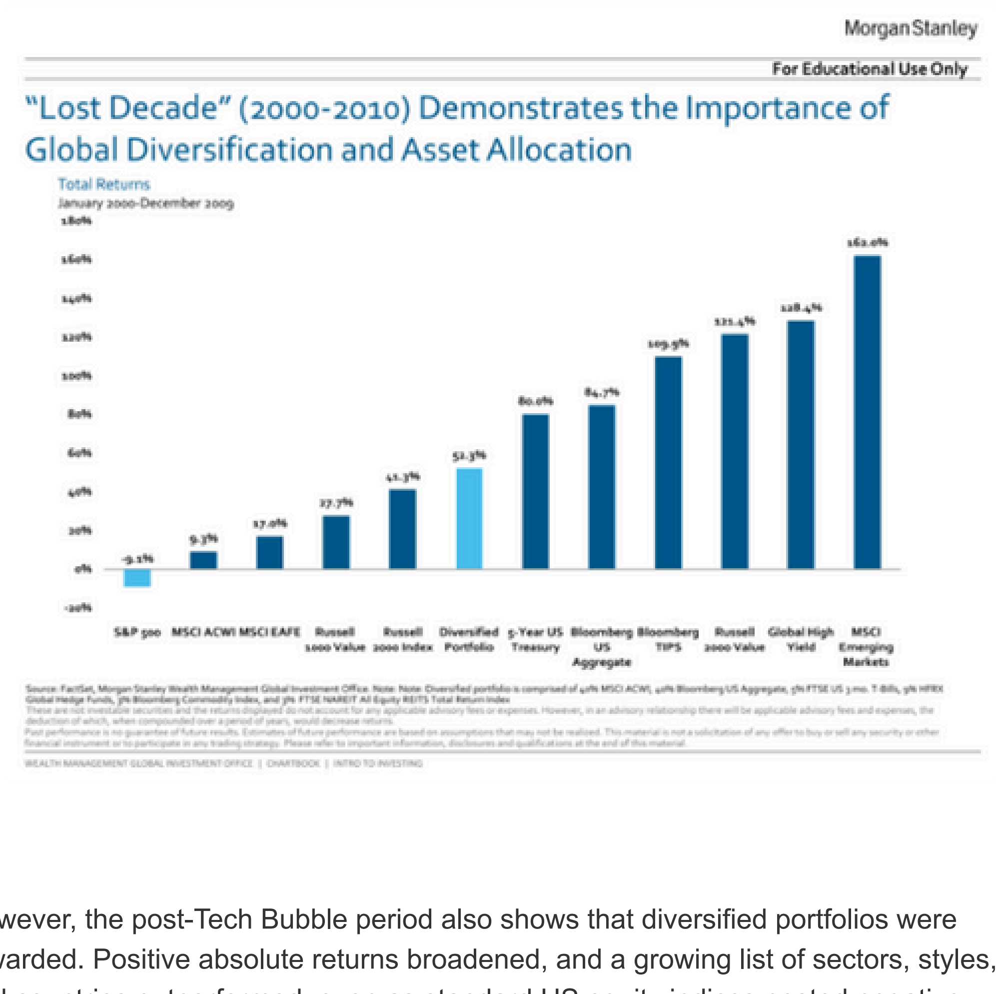
Markets have continued the string of volatile days in the first week of March. Through March 5th – this note was authored on the 6th -- the S&P 500 is negative on the year as is the Nasdaq, which is quickly approaching correction territory – down 10 percent from its February high. From our team's perspective, we had reasonably forecast what's happening in markets – a sell-off in the pervious cycle's winners with a rotation into other sectors. Consider that through March 6th, diversified portfolios have performed reasonably well. The average stock around the globe has done just fine despite the volatility; and bonds have rallied substantially since the year began. But within the universe of stocks, the average stock's gains have been more than offset on a market cap basis with large drawdowns in the big tech stocks and big consumer discretionary stocks. Consider the table of S&P 500 sectors below and their YTD performance. Every sector save Information Technology and Consumer Discretionary is actually positive or flat (Energy) on the year. MSCI EAFE is up 10.5 percent for the year, the MSCI EM is up 4.0 percent, and the MSCI All Country World index has gained 2.3 percent. The Barclays US Aggregate index has also gained 2.3 percent.

S&P 500 Sectors	Mar-05	1D	WTD	MTD	QTD	YTD	1Y
Communication Services	347.90	1.5%	-0.3%	-0.3%	2.0%	2.0%	31.1%
Consumer Discretionary	1,692.42	1.7%	-2.2%	-2.2%	-7.5%	-7.5%	17.4%
Consumer Staples	911.38	0.4%	-0.8%	-0.8%	7.0%	7.0%	17.9%
Energy	649.95	-1.5%	-5.8%	-5.8%	-0.0%	-0.0%	1.9%
Financials	834.20	0.6%	-3.8%	-3.8%	4.0%	4.0%	26.2%
Health Care	1,741.65	1.0%	0.4%	0.4%	8.9%	8.9%	5.0%
Industrials	1,131.25	1.6%	-1.8%	-1.8%	1.6%	1.6%	12.3%
Information Technology	4,315.45	1.4%	-2.2%	-2.2%	-6.3%	-6.3%	16.1%
Materials	553.15	2.6%	-0.8%	-0.8%	4.7%	4.7%	1.7%
Real Estate	272.56	1.0%	0.6%	0.6%	6.8%	6.8%	13.9%
Utilities	391.78	-0.7%	-2.2%	-2.2%	2.4%	2.4%	27.9%

Do we think the decline in the last cycle's winners will soon be over and this represents a buying opportunity in the Magnificent 7? The short answer is no. Consider that this change in leadership follows a very long (15 years) bull-market cycle dominated by US technology companies. Investors remain highly confident and highly concentrated in their portfolios even after the recent declines which are quite small in relation to the last several years' gains. Richard Bernstein advisors highlighted 4 key points in its February 25th note entitled Historically confident investors meet historically uncertain world. All of these points align tightly with our 2025 predictions.

- Investors are historically confident, are shunning diversification, and are taking historic portfolio risk.
- That extreme risk taking is juxtaposed with a world that is historically uncertain.
- Investors are looking at diversification as a lead weight on performance rather than as a time-tested risk-reduction tool.
- We're not bearish. Narrow markets suggest index funds might face headwinds as 2025 progresses, but broader markets continue to present generationally attractive opportunities.

Bernstein writes "The narrow market implies that investors in index funds might indeed have some performance headwinds during 2025 as "the market" (which is effectively 7-10 stocks) has to contend with reduced economic liquidity. Judging by the post-Tech Bubble's "lost decade in equities," index funds might secularly underperform.



However, the post-Tech Bubble period also shows that diversified portfolios were rewarded. Positive absolute returns broadened, and a growing list of sectors, styles, and countries outperformed, even as standard US equity indices posted negative returns.

So 2025 and beyond might be a difficult period for index fund investors and "the market" might post negative returns, but diversified equity portfolios might be entering a secular period of not only relative outperformance, but also positive absolute returns. That doesn't seem bearish to us at all."

That's a pretty good summation of our thoughts about 2025 as we entered the year. Nothing that has happened so far has dissuaded us from our original view – if anything, we feel emboldened. Presently the average US investor is down for the year because the average investor owns mostly US tech stocks. But the average diversified portfolio has performed well.

Furthermore, we don't think today's uncertainties will abate – quite the opposite. If we had to guess, we'd guess that tariffs will moderate from the market's current expectations. But who knows? While we mean this observationally and not politically, a key component of the Trump administration's tariff and overall negotiation strategy seems to be to keep the other side guessing. That leaves markets guessing as well.

So, what is our team's guess? As it has been, our guess is tariffs (this is a great paper on the history of tariffs in the US) are here to stay. Whether we agree with the political goals of protectionist policies or not, we feel confident the Trump administration plans to use tariffs in an effort to raise revenue for the Federal government, protect US industries in the hope of spurring more domestic manufacturing, and achieve more reciprocity in trade policy. The administration ultimately hopes to create higher-paying jobs for Americans with these policies in an effort to offset a 65-year-long trend downward in the share of GDP accruing to wages – from about 51.6 percent in 1969 to 42.2 percent in 2024. What matters to us with regard to your portfolio: any investor hoping for a quick end to the tariff issue will likely be disappointed until at least 2028. We also expect significant volatility in the application of tariffs over the rest of 2025.

We'd also guess the growth/recessionary implications of tariffs sublimate to some degree the inflation concerns – i.e. inflation may very well continue to fall for the full year despite the tariffs as the global economy cools down and slack in the system largely offsets the direct price effects of tariffs. We worry our saying this will make someone think we are denying the inflationary effects of tariffs – which are simply tax increases – and we are not. We are not making a political statement here. All else held equal, Tariffs increase prices just like any other tax on a good or service would. We do mean to say that the linear analysis offered by most pundits considers the direct price/inflation effect, but not the residual growth effect down the road. With regard to portfolio construction, we must consider all the angles. In the net analysis, a slowdown in global growth as a consequence of increased protectionism and decreased government spending (DOGE) portends a decline in long term US interest rates and a difficult environment for mega-cap multinational US stocks. In that environment, it would also not shock us if international investments and bonds continue to buoy diversified portfolios despite declines in the major US market-cap weighted stock indices.

Morgan Stanley's Global Investment Committee holds a more nuanced view and thinks that "In the event that tariffs are broader, more durable and implemented sooner than our current outlook, upside risks to inflation and downside risks to growth would be further amplified. If tariffs on Canada and Mexico stay in place, and the additional China tariffs continue, we anticipate that they will boost headline personal consumption expenditures (PCE) by 0.3 to 0.6 percentage points and reduce real GDP growth by 0.7 to 1.1 percentage points (see table). Declining real consumption, investment spending, employment and labor income are the channels that affect real GDP growth. Increases in inflation, meanwhile, result from the direct pass through of higher import prices into PCE goods inflation and from higher imported intermediate input costs.

In the gradual-tariff-implementation scenario, our view is that the inflation deceleration trend would remain intact—with core PCE at 2.6% on a year-over-year basis by the March Federal Open Market Committee (FOMC) meeting and 2.4% by April. With downside risks to the labor market less apparent, this would likely have allowed the Fed to ease."

Policy Action		Economic Impact (range)					
		Headline PCE Prices	Real Consumer Spending	Real Investment	Real Exports	Real Imports	Real GDP
Trump Trade Proposal	25% incremental tariff on Mexican and Canadian imports and incremental 10% tariff on Chinese imports	0.3% to 0.6%	-2.0% to -1.6%	-2.2% to -1.0%	-1.3% to -0.9%	-5.1% to -4.6%	-1.1% to -0.7%

But consider in defense of our team's view that the lower growth side of the tariff equation might be priced more quickly than Morgan Stanley suggests above: the price of oil has actually declined this year by about 4.8 percent through March the 5th – and our team thinks headline CPI (which includes energy prices) may very well decline in March or at least offer no inflation month-over-month as a consequence. The Federal Reserve Bank of Cleveland "Nowcast" currently has March headline CPI at 0.01 percent. While energy markets are not the end-all be-all of inflation data, they do have an excise effect since shipping costs make up a significant portion of final consumer experienced prices on most goods. The Federal Reserve Bank of Atlanta has a similar "GDPnow" estimate for March that shows economic contractions of -2.4 percent.

So what's our conclusion? Stay diversified and expect volatility in 2025 – volatility in everything: markets, inflation data, trade policy, GDP growth, and policy shifts. As we said at the beginning of the year, we would have been surprised if we didn't experience an equity market correction this year. That does not mean we think returns will be negative for the year for diversified asset-allocation portfolios. Don't be surprised if the winners of the last 15 years are the losers in 2025. Don't be surprised if the average US investor has a terrible year but the average investor with a meaningfully diversified portfolio comes out just fine. It's started out that way so far, and we think come December 31st, that's likely to be the case for the full 12 months.

As always, if you have any questions or concerns, please don't hesitate to give us a call.